Nos. 15757, 15758, and 15759

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

RUTH WOLINS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' OPENING BRIEF.

BRYANT R. BURTON,
ADRIAN P. MARSHALL,
611 Wilshire Boulevard,
Los Angeles 17, California,
Attorneys for Appellants.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Cases

Regulations and Rules

Statutes

Other Authorities

Nos. 15757, 15758, and 15759

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

RUTH WOLINS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' OPENING BRIEF.

This is a joint appeal on behalf of Laurence V. Kanter, Jerome B. Kanter and Ruth Kanter Wolins from final judgments entered July 29, 1957, in the companion cases of *Laurence V. Kanter v. United States of America, Ruth Wolins v. United States of America,* and *Jerome B. Kanter v. United States of America;* judgment in each of said cases was based upon substantially identical Findings of Fact and Conclusions of Law, and decreed that appellants take nothing by their respective individual complaints for the recovery of income taxes alleged to be erroneously and illegally collected. [R. 29-45.]

I.
PRELIMINARY STATEMENT.

On March 4, 1957, the above-named cases were jointly tried pursuant to stipulated facts and documentary exhibits; no testimony was offered or received into evidence. [R. 17-28, 47-81.] Following the entry of judgment in each case on July 29, 1957 [R. 45; Tr.* 77, 111] and the filing of Notices of Appeal in each case on September 19, 1957 [R. 46; Tr. 79, 113], a stipulation between counsel for the respective parties was entered into whereby it was agreed, in essence, that, while the certified record in the case of *Laurence V. Kanter v. United States of America* only would be printed, the entire records in the companion cases of *Laurence V. Kanter v. United States of America, Ruth Wolins v. United States of America,* and *Jerome B. Kanter v. United States of America* certified to this Court by the Clerk of the United States District Court for the Southern District of California, Central Division, are material to the consideration of this appeal, and that matters contained in the certified records which are not part of the printed record may be referred to by any party in briefs or arguments. [R. 87.] On October 22, 1957, Chief Judge Stephens endorsed an order permitting the filing of single briefs covering all three cases. [R. 90.]

---

*The designation "Tr." refers to the unprinted portions of the Transcript of Record sent to the clerk of the Court of Appeals for the Ninth Circuit by the clerk of the United States District Court.

II.
JURISDICTIONAL STATEMENT.

In re Appellant, Laurence V. Kanter:

On or about November 1, 1948, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Laurence V. Kanter in the amount of eight hundred three dollars and seventy-two cents ($803.72), plus interest, and on or about March 15, 1949, Laurence V. Kanter paid said amount, plus interest, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. [R. 7, 8.] On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the years 1946 and 1947 against Laurence V. Kanter in the amount of three thousand four hundred eighty-eight dollars and sixty-four cents $3,-488.64), plus interest, and five thousand four hundred ninety-two dollars and sixty-two cents ($5,492.62), plus interest, respectively. Laurence V. Kanter paid said amounts, plus interest. [R. 8, 9.] All of said deficiencies related to the inclusion in the gross income of Laurence V. Kanter of income of the trust of which he was the primary beneficiary.

On or about August 12, 1950, Laurence V. Kanter filed a written claim for refund of the sum of eight thousand six hundred fifty dollars and thirty-three cents ($8,650.33), plus interest, for income taxes and interest allegedly erroneously collected from him. [R. 9.] On April 5, 1951, the Commissioner of Internal Revenue dis-

allowed the claim for refund respecting the years 1946 and 1947; disallowance of the claim for refund respecting the year 1945 was not received by Laurence V. Kanter within six (6) months of the time of the filing of his claim. [R. 9, 10, 12.]

On April 3, 1953, Laurence V. Kanter, a resident of the County of Los Angeles, State of California, within the Sixth Internal Revenue Collection District of the State of California, filed a civil action in the United States District Court for the Southern District of California, Central Division, seeking recovery of the individual income taxes and interest thereon allegedly erroneously and illegally collected. [R. 3.] The United States District Court had jurisdiction pursuant to Section 1346(a)(1) of 28 U. S. C. Findings of Fact, Conclusions of Law and Judgment in favor of defendant and against Laurence V. Kanter were filed July 26, 1957, and judgment entered on July 29, 1957. [R. 29.]

Notice of Appeal from the final judgment was filed September 19, 1957. [R. 46.] The jurisdiction of this Court to review the final judgment is conferred by Section 1291 of 28 U. S. C.

In re Appellant, Ruth Wolins:

On or about November 1, 1948, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Ruth Wolins in the amount of eleven hundred twenty-nine dollars and thirty cents ($1,129.30), plus interest, and on or about March 15, 1949, Ruth Wolins paid said amount, plus interest, to

the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes against Ruth Wolins in the amount of four thousand four hundred eighty-two dollars and seventy cents ($4,482.70), plus interest, respecting the year 1946 and eight thousand two hundred seventy-eight dollars and seventy-seven cents ($8,278.77), plus interest, respecting the year 1947. On or about June 9, 1949, Ruth Wolins paid both of said amounts, plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. All of said deficiencies related to the inclusion in the gross income of Ruth Wolins of income of the trust of which she was the primary beneficiary.

On or about August 12, 1950, Ruth Wolins filed a written claim for refund of the sum of nine thousand seven hundred eighty-two dollars and fifty-three cents ($9,782.53), plus interest, for income taxes and interest allegedly erroneously collected from her. On April 18, 1951, the Commissioner of Internal Revenue disallowed the claim for refund respecting the years 1945, 1946 and 1947.

On April 16, 1953, Ruth Wolins, a resident of the County of Los Angeles, State of California, within the Sixth Internal Revenue Collection District of the State of California, filed a civil action in the United States District Court for the Southern District of California, Central

Division, seeking recovery of the individual income taxes and interest thereon allegedly erroneously and illegally collected. [Tr. 62, *et seq.*]

The United States District Court had jurisdiction pursuant to Section 1346(a)(1) of 28 U. S. C.. Findings of Fact, Conclusions of Law and Judgment in favor of defendant and against plaintiff were filed July 26, 1957, and judgment was entered July 29, 1957. [Tr. 62.]

Notice of Appeal from the final judgment in said action was filed on September 19, 1957. [Tr. 79.] The jurisdiction of this Court to review the final judgment is conferred by Section 1291 of 28 U. S. C.

In re Appellant, Jerome B. Kanter:

On or about January 7, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Jerome B. Kanter in the amount of three hundred seventy-five dollars and thirty-two cents ($375.32), plus interest, and on or about March 15, 1949, Jerome B. Kanter paid said amount, plus interest, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. On or about May 20, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes against Jerome B. Kanter in the amount of two thousand four hundred sixty-one dollars and twenty-three cents ($2,461.23), plus interest, respecting the taxable year 1946 and three thousand six hundred twenty-four dollars and seventy-four cents ($3,624.74), plus interest, respecting the taxable year 1947. Jerome B. Kanter paid both of said amounts, plus interest, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. All of said deficiencies

related to the inclusion in the gross income of Jerome B. Kanter of income of the trust of which he was the primary beneficiary.

On or about August 12, 1950, Jerome B. Kanter filed a written claim for refund of the sum of five thousand eighty-two dollars and ninety-one cents ($5,082.91), plus interest, for income taxes and interest allegedly erroneously collected from him. On May 24, 1951, the Commissioner of Internal Revenue disallowed the claim for refund respecting the calendar years 1945 and 1947; disallowance of the claim for refund respecting the year 1946 was not received by Jerome B. Kanter within six (6) months of the filing of his claim.

On May 21, 1953, Jerome B. Kanter, a resident of the County of Los Angeles, State of California, within the Sixth Internal Revenue Collection District of the State of California, filed a civil action in the United States District Court for the Southern District of California, Central Division, seeking recovery of the individual income taxes and interest thereon allegedly erroneously and illegally collected. [Tr. 83 *et seq.*]

The United States District Court had jurisdiction pursuant to Section 1346(a)(1) of 28 U. S. C.. Findings of Fact, Conclusions of Law and Judgment in favor of defendant and against plaintiff were filed July 26, 1957, and judgment was entered July 29, 1957. [Tr. 96.]

Notice of Appeal from the final judgment was filed September 19, 1957. [Tr. 113.] The jurisdiction of this Court to review the final judgment is conferred by Section 1291 of 28 U. S. C.

III.
STATEMENT OF THE CASE.

(A) Question Presented.

The sole question presented by this consolidated appeal is whether, during the taxable periods in question, the years 1945, 1946, and 1947, the income of three (3) irrevocable trusts, accumulated and undistributed in accordance with the terms of the trust instruments, should be attributed and taxable to the appellants, as primary beneficiaries of the respective trusts, because of the similarity of the provisions of the trust instruments and the business and familial relationships existing between the trustees and the primary beneficiaries.

All evidence received during the joint trial of the three (3) cases was comprised of stipulations of fact entered into between counsel for the respective parties and documentary exhibits. All of said evidence is contained in the record on appeal. [R. 17-28, 47-81.] The sole question involved was raised in briefs filed in the District Court. The question for review before this Court is whether the District Court correctly applied the legal principles applicable to the undisputed evidence. Appellate review is preserved by virtue of Rule 52(b) of the Federal Rules of Civil Procedure. *Monaghan v. Hill,* 140 F. 2d 31 (9th Cir., 1944).

(B) Statutes and Regulations Involved.

Pertinent provisions of applicable Statutes and Treasury Regulations which are referred to and which are not sufficiently set forth in the body of this brief are contained in the appendix.

(C) Statement of Undisputed Facts.

(1) Background.

During the early part of the year 1944, the Kanter family owned all of the stock of Shop 'N Save, a California corporation. The three (3) children, Laurence V. Kanter, Jerome B. Kanter and Ruth Kanter Wolins, each owned 6.81 per cent of the stock, the father, Harry L. Kanter, owned 13.31 per cent of the stock and the mother, Minnie Kanter, owned the remaining 66.26 per cent of the stock. [R. 31.]

On March 3, 1944, Minnie Kanter, desiring to make gifts of portions of her stock interest, created three (3) separate trusts for the benefit of her three children and the potential benefit of the issue of her children. No business purpose existed for the gifts and trusts created thereby. [R. 18, 31.] In all respects the gifts were valid, Minnie Kanter having effectively parted with all control over the property transferred in trust and having paid gift taxes on the transfers. [R. 19, 31.] In effecting the gifts, the trust medium was employed in order to reduce the income taxes that the children would have to pay on the income from the property gifted to them. [R. 31, 74.] In assessing gift taxes due, the Commissioner of Internal Revenue would not allow the three-thousand ($3,000.00) annual exclusion for gifts to individuals, contending that the transfers in trust represented gifts of future interests. The benefits of the three thousand dollar annual exclusion claimed by Minnie Kanter in her tax return filed March 15, 1945, were thus denied and she accordingly paid a gift tax deficiency of seven hundred forty-two dollars and fifty cents ($742.50). [R. 20.]

(2) Principal Provisions of the Trust Instruments.

(a) Trustees and Primary Beneficiaries.

The trustees of the trusts wherein Laurence V. Kanter was the primary beneficiary, hereinafter sometimes referred to as the Laurence V. Kanter Trust, were Laurence's sister, Ruth Kanter Wolins, and her husband, Albert Wolins. The trustees of the trust wherein Jerome B. Kanter was the primary beneficiary, hereinafter sometimes referred to as the Jerome B. Kanter Trust, were Ruth Kanter Wolins and Laurence V. Kanter, sister and brother respectively of Jerome. The trustees of the trust wherein Ruth Kanter Wolins was the primary beneficiary, hereinafter sometimes referred to as the Ruth Kanter Wolins Trust, were her husband, Albert Wolins, and her brother, Laurence V. Kanter. [R. 18, 32.]

Paragraph "Twelfth" of the respective trust instruments provided that the trustees shall be joint trustees and their joint signatures necessary for the performance of any acts. Paragraph "Twelfth" provided additionally that the Bank of America National Trust and Savings Association would become the trustee in the event that both trustees could not or would not act. [R. 56.] Pursuant to the second paragraph of the trust instruments, the trustees had broad investment powers over the trust corpus. [R. 48.]

(b) Secondary Beneficiaries.

Pursuant to the terms of the Ruth Kanter Wolins Trust, Albert Wolins, Laurence V. Kanter and Jerome B. Kanter were "secondary beneficiaries" thereof, Albert Wolins possessing an interest in the trust property contingent on Ruth's death before January 2, 1960, and

Jerome B. Kanter and Laurence V. Kanter having interests contingent on Ruth's death before January 2, 1960, without lawful issue or a lawful spouse surviving her. Likewise, in addition to being trustees of the Jerome B. Kanter Trust, Ruth Kanter Wolins and Laurence V. Kanter were "secondary beneficiaries" thereof, each having interests contingent on Jerome B. Kanter's death before January 2, 1960, without lawful issue or lawful spouse surviving him. Jerome B. Kanter and Ruth Kanter Wolins were likewise similar contingent and "secondary beneficiaries" of the Laurence V. Kanter Trust. [R. 32, 51.]

(c) Accumulation and Distribution of Trust Income.

The third paragraph of each of the trust instruments provided that the term of the trust was established at fifteen (15) years and ten (10) months. After dividing this term into three (3) parts, the trust instruments provided that all income from March 3, 1944, to January 2, 1950, "shall be held in said Trust Estate as undistributed income and shall be available for distribution and shall be distributed to the beneficiary hereof on the 2nd day of January, 1950." [R. 50.]

The fifth paragraph in each of the trust instruments provided that:

> "In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation." [R. 52.]

Paragraph "Sixth" of the respective trust instruments contained provisions prohibiting the sale, assignment, hypothecation, or transfer by any beneficiary of any beneficial interest in the trust estate and required the personal receipt of the designated beneficiary as a condition precedent to payment to such beneficiary. [R. 52.]

There is no power existing in any party to invade the corpus of the respective trust estates.

(3) Events During the Taxable Years in Question.

On or about April 1, 1944, Shop 'N Save Corporation was partially liquidated and a limited partnership under the name of Kanter & Wolins was organized. On the partial liquidation of the corporation, the shares of capital stock held by the shareholders were cancelled in exchange for interests as limited partners in the assets and profits of Kanter & Wolins. The shares of capital stock which were to have been placed in the corpus of each trust executed by Minnie Kanter were thus cancelled, and the value of the corpus of each trust was credited to the capital account of each trust on the books of the Kanter & Wolins partnership. [R. 18, 33.]

All transactions affecting the trusts were reflected in the capital accounts of the trusts as limited partners on the books of the partnership. A Certificate of Limited Partnership was executed and filed in the office of the County Recorder of Los Angeles County on April 1, 1944. This Certificate showed that the general partners were Harry L. Kanter, Laurence V. Kanter, and Albert L. Wolins; the limited partners were Minnie F. Kanter, Jerome B. Kanter, Ruth Wolins, the trusts with which we are concerned and a fourth trust not involved in these proceedings. [R. 33.]

During the years 1945, 1946 and 1947, the taxable periods in question, the limited partnership filed income tax returns on which it listed each of the aforementioned trusts as being limited partners, and as such chargeable with their distributable shares of the partnership profits. During such years, the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Kanter Wolins Trust did not distribute any part of the trust income to the beneficiaries. [R. 19, 35.]

(4) Liability for and Payment of Taxes.

On or before the 15th day of March, 1946, the 15th day of March, 1947, and the 15th day of March, 1948, the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Kanter Wolins Trust prepared and filed on behalf of each trust fiduciary income tax returns for the calendar years 1945, 1946 and 1947, respectively. In each fiduciary return the trust's 6.81 percentage of the distributable share of the Kanter & Wolins partnership income for the aforesaid taxable years was reported. [R. 20-21, 35.] Because such trust income was not distributed to the beneficiaries, the returns reported and showed a tax payable by the respective trusts on account of such income. The income taxes due respecting such income were duly paid by the trustees of each of the trusts to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. [R. 20-22, 35.]

Thereafter, the Commissioner of Internal Revenue determined that the income of the trusts of which each of the appellants was the primary beneficiary was includible in their individual gross income and assessed deficiencies accordingly. The alleged deficiencies were paid, timely

claims for refund filed and subsequently disallowed or not acknowledged within six (6) months of the time of the filing of the claims. [R. 22-27, 36.]

Timely suits for refund were instituted in the District Court, by each appellant, seeking recovery of the amounts claimed in their claims for refund together with interest. [R. 3, Tr. 49, 83.]

IV.
SPECIFICATION OF ERRORS.

The Trial Court erred:

(1) In admitting into evidence Defendants' Exhibit "B"; this exhibit, a second supplementary stipulation of facts between counsel for the respective parties, contained principally a series of statements of events pertaining to years subsequent to the taxable years in question; viz, acquisition by the Kanter & Wolins partnership of stock in a corporation in the year 1950 and loss resulting from said acquisition in later years. [R. 77-81.] For this reason, admissibility of this evidence was objected to on grounds of irrelevancy and immateriality. [R. 77.]

Most of the tax legislation of the past two decades amply illustrates that the incidence of the income tax is apportioned between a trust and its beneficiaries on a year-by-year basis; *e.g.,* 65 day and 12 month rules, Section 111 of the Revenue Act of 1942. The events and transactions of the particular taxable year in question determine the incidence of taxation for that year. *Burnet v. Sanford & Brooks Company,* 282 U. S. 359, 51 S. Ct. 150 (1931). Thus, it has been held that, in order to tax the undistributed income of a discretionary trust to the beneficiaries under Section 22(a) of the Internal

Revenue Code of 1939 on the theory that they could have demanded payment of the income, it is essential that the right to demand payment exist during the taxable year in question. Section 6.27 of Kennedy, Federal Income Taxation of Trusts and Estate (1948); *Hallowell v. Commissioner of Internal Revenue,* 160 F. 2d 536 (3rd Cir., 1947; *Samuel B. Knight,* 6 T. C. 90 (1946) (Acq.). In this regard, the events of subsequent years are not material. *Cf., Parker v. Westover,* 221 F. 2d 603 (9th Cir., 1955).

(2) In finding [in its Finding of Fact No. XXVI in each case] that the beneficiaries of the trusts had unlimited power and control over the corpus of the trusts in that said Finding of Fact is contrary to law, is not supported by any substantial evidence in the record and is not inferable from the reasons so stated in support of said Finding, to wit, the reciprocal nature of the trusts, the lack of independent trustees, the close familial, business and trust relationship of the trustees with each other, and the unlimited power in invasion of the corpus.

The respective trustees and beneficiaries were not settlors of the trusts in question; thus, although, the provisions of the respective trusts are identical except for the differences in the trustees and beneficiaries, the trusts were not "reciprocal"; *i.e.,* they were not created in consideration of the creation of the others.

Again because the respective beneficiaries were not the settlors of any of the trusts in question and hence did not select the fiduciaries, the relationship of the beneficiaries to the trustees does not establish that the trustees are amenable to the beneficiaries.

Nowhere in any of the provisions of the trusts in question is there any power to invade the trust corpus.

(3) In failing to find as a fact that there was no evidence that the beneficiaries of the trusts had any express power over the corpus or income of the trusts or had exercised any control over the corpus or income of the trusts.

No provision of the trust instruments gave the beneficiaries any power over the corpus or income of the respective trusts. Further, there is no evidence that any beneficiary actually exercised any control over the corpus or income of the trusts.

(4) In concluding (in its Conclusion of Law No. II in each case) that the plaintiffs have failed to sustain their burden of proof that they have overpaid income taxes for the years 1945, 1946 and 1947, in that said Conclusion of Law is contrary to law, contrary to the evidence and inconsistent with the District Court's Findings of Fact numbered XI, XII and XVII.

Findings of Fact numbered XI, XII and XVII demonstrate that the trustees had discretion to distribute or accumulate income, that they did not distribute any income and hence paid income taxes on the accumulated amounts accordingly. Since the respective beneficiaries never received a distribution during the taxable years in question, they are not taxable on the trust income. Sections 161(a)(4) and 162(c) of the Internal Revenue Code of 1939.

(5) In concluding (in its Conclusion of Law No. III in each case) that the undistributed income of the trusts was the income of the beneficiaries as earned by the Kanter & Wolins partnership and was properly taxed to the beneficiaries rather than to the trust in that said Conclusion of Law is contrary to law, contrary to the

evidence and inconsistent with the District Court's Findings of Fact numbered XI and XII.

This conclusion is erroneous for the same reasons stated in Specification of Errors No. 4 above.

(6) In concluding (in its Conclusion of Law No. IV in each case) that the beneficiaries had such control over the corpus of the trusts as to make the income therefrom their own in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record.

No provision of the trust instruments gave the beneficiaries any power over the corpus or income of the respective trusts; further, there is no evidence that any beneficiary actually exercised any control over the corpus or income of the trusts.

(7) In concluding (in its Conclusion of Law No. V in each case) that the three (3) trusts established by Minnie Kanter lacked substance and reality and were not valid under the income tax laws in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record.

(8) In concluding (in its Conclusion of Law No. VI in each case) that the beneficiaries of the respective trusts were as much the owners of the income paid by the Kanter & Wolins partnership to the various trusts as they were with respect to the income paid directly to them as limited partners in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record.

(9) In failing to conclude as a matter of law that the undistributed income of the respective trusts was the income of the trust and not the income of the beneficiaries thereof.

This conclusion followed from the reasoning stated in Specification of Errors No. 4 above.

(10) In failing to conclude as a matter of law that plaintiffs overpaid their income taxes for the years 1945, 1946 and 1947, and are entitled to recover from the defendant the amounts so paid, together with interest thereon as provided by law.

The income for the years in question was accumulated and thus properly taxed to the respective trusts.

V.
SUMMARY ARGUMENT.

Whether there is warrant in the record and a reasonable basis in the law for the legal conclusion of the District Court that appellants were in substance the owners of the respective trust estates is a judicial question subject to review by this Court.

1.

The trusts were "discretionary trusts." Pursuant to Sections 161(a)(4) and 162(c) of the Internal Revenue Code of 1939, a beneficiary of a "discretionary trust" is taxed only upon distributions received by said beneficiary. Income which is accumulated by the fiduciary is taxable to the trust.

All income for the taxable years in question was accumulated; none was distributed. Income taxes were therefore properly attributed and taxable to the trusts and not to the appellants as beneficiaries thereof.

2.

An exception to the statutory pattern of taxation arises when income is subject to one's unfettered command during the taxable year, in which event he may be taxed on such income whether or not he elects to receive it.

However, trust income or corpus is subject to a person's unfettered command only where a provision of the trust instrument gives such person express power over the trust income or corpus tantamount to ownership or where, absent such express power, such person actually enjoys the income.

None of the provisions of the trust instruments in question provided the appellants with power to deal with the trust property in a manner consistent with ownership, nor was any of the income of the trusts received by appellants.

3.

The reasoning expressed by the District Court in support of its Findings and Conclusions that the appellants, as beneficiaries of the respective trusts, had unlimited power and control over the corpus of the trusts, has no foundation in law or fact.

(a) Nowhere in any of the trust instruments is there a power to invade trust corpus;

(b) Although the provisions of the respective trusts are similar, the trusts are not "reciprocal"—they were not created by the appellants in consideration of the creation of the others. There is thus no reason in law or fact to transpose the positions of the appellants and trustees;

(c) There is no evidence of the exercise of control on the part of the appellants, and no inference arises that, because of the relationship of the trustees and appellants, the trustees are amenable to the appellants.

Under the *Clifford* decision, the concept of family unity is an economic consideration rather than one of conduct and behavior.

An inference arises that, because the "secondary" interests of the trustees in the trusts are "substantially adverse" to that of the appellants, the trustees are not amendable to the appellants.

Pursuant to the explicit provisions of Treasury Regulations 111, Section 22(a)-22, only when a person other than the grantor is *solely* empowered to control trust income or corpus is the trust income attributed to such person.

4.

Substantial and irrevocable gifts were made through the creation of the trusts; the donor effectively parted with all control over the trust property. Tax savings motives do not thereby render the trusts invalid.

Absence of a business purpose in establishing the trusts, when the presence of such purpose would have resulted in taxation of the trusts as corporations, is immaterial.

Conclusion.

Firmly established precedent which requires that one who does not receive income have, at least, the right to receive it before he may be taxed thereon, has not been followed by the District Court in these matters. The decision of the District Court results in appellants being taxed on something they neither received nor were in a position to demand the receipt of.

The intent of Congress, expressed in recent statutory enactments, is that specific statutory guides should be followed in rendering decisons based upon the *"Clifford"* doctrine. The guides have not been followed by the District Court in these matters.

VI.

ARGUMENT.

Whether the appellants, as primary beneficiaries of the trust instruments in question, had sufficient control over the trust property to make them the owners thereof, so as to be subject to taxation on the income therefrom, is a question of law subject to appellate review. *Hall v. Commissioner of Internal Revenue,* 150 F. 2d 304 (10th Cir., 1945); *Helvering v. Bok,* 132 F. 2d 365 (3rd Cir., 1942). Additionally, because all of the evidence before the District Court consisted of undisputed facts and documentary exhibits, this Court may consider the evidence *de novo*; *Smyth v. Barneson,* 181 F. 2d 143 (9th Cir., 1950), and may draw its own inferences therefrom; *Pacific Portland Cement Company v. Food Machinery and Chemical Corporation,* 178 F. 2d 541 (9th Cir., 1949).

1.

The Trusts Were "Discretionary" Trusts and All Accumulated Income Was Properly Attributable and Taxable to the Trusts and Not to the Primary Beneficiaries.

Pursuant to the terms of the fifth paragraphs in each of the trust instruments with which we are concerned, the accumulated income of the respective trusts could be distributed to the beneficiaries at any time in the discretion of the trustees [R. 52]; thus, as such, the trusts were so-called "discretionary trusts." The statute itself provides how the income of a so-called "discretionary trust" shall be taxed. Section 161(a)(4) of the Internal Revenue Code of 1939 provides, in part, that

> "The taxes imposed by this chapter . . . upon individuals shall apply to the income of estates or

of any kind of property held in trust, including . . . (4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated."

Section 162(c) of the Internal Revenue Code of 1939, as pertinent, provides that,

> "The net income of the . . . trust shall be computed in the same manner and on the same basis as in the case of an individual except that . . . (c) in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the . . . trust the amount of the income of the . . . trust for its taxable year, which is properly paid or credited during such year to any . . . beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the . . . beneficiary;"

Thus, if income were retained and accumulated by the fiduciary, it would be taxable to the trust. If the fiduciary distributed income, the trust would obtain credit through a special deduction and the beneficiary would report the income.

Counsel for the Government have stipulated that none of the trust income for the taxable periods in question was distributed to the appellants [R. 19-21]; the tax on said income was therefore properly attributed and taxable to the trusts. Income tax was accordingly paid on the income by the respective trustees pursuant to the express provisions of the revenue law. The law does not require more.

Despite the express terms of the trust instruments and regardless of the agreed stipulated fact that no distribution of trust income was made to any of the appellants during the taxable years in question, the District Court has attributed the entire undistributed income of these periods to the appellants, as primary beneficiaries of the respective trusts, because it concluded that they had "unlimited control over the corpus of the trusts"; the reasons expressed for this conclusion are the reciprocal nature of the trusts, the lack of independent trustees, the close familial, business and trust relationship of the trustees with each other, the unlimited powers of invasion of the corpus and the fact that the creation of the trusts had no business purpose and was motivated with tax savings in mind. [R. 42.]

This general conclusion of the District Court was undoubtedly based upon the large body of case law which has developed since the renowned decision of *Helvering v. Clifford,* 309 U. S. 331, 60 S. Ct. 554 (1940), and Treasury Regulations supplementing these decisions (Appendix) dealing with the interrelation of Section 22(a) and Sections 161 and 162 of the Internal Revenue Code of 1939.

The theme of these many cases may be summarized as follows:

> *Where income is subject to one's unfettered command during the taxable year and he is free to enjoy it at his own option, he may be taxed on such income whether he elects to enjoy it or not.*

In determining whether or not income *is* subject to one's unfettered command during the taxable year, all of the reported decisions point to a simple basic premise:

2.

Income or Corpus Is Subject to a Person's Control Only Where the Trust Instrument Gives Such Person Express Power Over Trust Income or Corpus Tantamount to Ownership or Where, Absent Such Express Power, There Is Evidence of Actual Power Exercised.

Probably the leading case sustaining this premise is *Mallinckrodt v. Nunan,* 146 F. 2d 1 (8th Cir., 1945). On page 1 of this opinion, the Court aptly sums up the crux of the case by stating,

> "By the *terms* of the instrument creating the trust, this undistributed income was *payable to petitioner* (trust beneficiary) annually *upon his request,* but, if not paid to him at his request, it was to be added to the corpus of the trust estate at the end of each year." (Italics and reference added.)

The Court phrased the issue as follows:

> "The question presented is whether the undistributed income of the trust in the years in question was taxable to petitioner or taxable to the trust."

and briefly concluded,

> "Since the trust income in suit was available to petitioner upon request in each of the years involved, he had in each of those years the 'realizable' economic gain necessary to make the income taxable to him."

The *Frank, Stix* and *Spies* cases, appearing in 145 F. 2d 413 (3d Cir., 1944), 152 F. 2d 562 (2d Cir., 1945), and 180 F. 2d 336 (8th Cir., 1950), respectively, are essentially indistinguishable from the *Mallinckrodt* case. In the *Frank* case, the beneficiary was given express power in the trust instrument to receive up to 50% of trust in-

come each year; in the *Stix* and *Spies* cases, the beneficiaries were also sole trustees and as such expressly empowered to pay over to themselves trust principal and income. Trust income was therefore properly attributed to the person thus expressly empowered in each of these cases.

In *Bunting v. Commissioner,* 164 F. 2d 443 (6th Cir., 1947), petitioner, the son of the grantor of the trust and neither a beneficiary nor a trustee, was given express power in the trust instrument to modify, amend, or add to the trust in any respect whatsoever, power to appoint himself as a beneficiary and power to revoke the trust instrument whereupon all trust income would be paid to petitioner. Similar to the *Bunting* case are the *Emery* case, 156 F. 2d 728 (1st Cir., 1946), the *Jergens* case, 136 F. 2d 497 (5th Cir., 1943), as well as *Corliss v. Bowers,* 281 U. S. 376, 50 S. Ct. 336 (1930). In all of said cases, there were provisions in the trust instruments which gave the taxpayer, whether he happened to be grantor, trustee, beneficiary, or third person, *express* power to deal with the income or corpus, as the particular case happen to be, in a manner consistent with ownership. Income of the trust was therefore properly attributable to said taxpayers.

No such express power is given the appellants in the trust instruments with which we are herein concerned. There is not one shred of evidence to sustain the District Court's Finding that the appellants, as primary beneficiaries of the respective trusts, had "unlimited power of invasion of the corpus." No such power existed. Unlike taxpayers in the above cited decisions, the appellants had no power to accept or reject payment of income annually, or to withdraw any part of the trust corpus, or to alter, amend, or modify the trusts. Under such circumstances,

when appellants did not receive any income and were not empowered to receive any income, there is no warrant for attributing and taxing the income of the trusts to them.

In *W. C. Cartinhour,* 3 T. C. 482 (1944), (Acq.), consideration was given to several decisions pertinent to this appeal. In this case, a husband and wife joined in the creation of a trust for the benefit of their minor children, the husband contributing non-income producing insurance policies upon his life and the wife contributing income producing policies. The husband and a banking company were named as co-trustees. The trustees were empowered to hold and manage the trust funds

> "with full power to invest and reinvest any part of the trust estate according to their sole judgment and discretion and are not to be subject to any restriction or limitation by reason of the laws of the State of Tennessee with respect to investments of trust funds so long as Cartinhour (the husband) shall be one of the trustees. . . ." (Reference added.) 3 T. C. 482 at 484.

Additionally, the trustees were directed to disperse the share of the income to the beneficiaries of the trust "in such manner, for the support, education and assistance of such child as the trustees in the exercise of their judgment may deem proper." 3 T. C. 482 at 485. The trustees also had power to encroach on the trust corpus for the support, education and assistance of the beneficiaries.

The husband was given the further right, during his life, to request the resignation of the named bank as trustee and to appoint a successor trustee, and in the event of difference of views between the co-trustees in voting the shares of stock, the views of the individual trustee or

trustees were to prevail. On page 486, the Court states as follows:

> "Respondent's (Commissioner) first contention is that Cartinhour is taxable upon the income of the trust under the provisions of Section 22(a). . . ."

and continued as follows on page 488,

> "While it is apparent from the above, that petitioner was given broad powers over the trust corpus and income, they were not, in our opinion, quite so broad or far reaching as were those given to the taxpayers in the two cited cases. He did not have the power to withdraw all or any part of the corpus of the trust, or to alter, amend or modify, or revoke it in whole or in part, possessed by the taxpayer in the *Jergens* case, nor did he have the right to terminate the trust at any time and to take over the trust property as his own, such as was possessed by the taxpayer in the *Richardson* case. The question arises, therefore, whether the absence of these powers is sufficient to distinguish the instant proceedings from those relied upon by the respondent. In other words, can it be said, as was said in those cases, that the property and the income therefrom was *so clearly subject to petitioner's unfettered command that they were, in substance, his?*" (Italics added.)

After discussing several cases the Court summarized as follows, on page 489:

> "The control over the income exercised by the grantor must be 'very substantial' if the income is to be considered his.
>
> "While it is true that Cartinhour was given rather broad powers with respect to the management of the trust estate, they were given to him in the fiduciary capacity of trustee, and not as an individual. As

> heretofore pointed out, he did not have the power to alter, amend, revoke, or terminate the trust, nor could he vest title to the corpus in himself. The only benefit he could receive from the income was in the event he and his co-trustee exercised the discretionary power given to them to distribute it for the support, education, or assistance of the beneficiaries, his minor children. The discretionary power was not exercised and no part of the income was used for this purpose during the taxable years."

Appellants, like the petitioner in the *Cartinhour* case, had no power to revoke, amend or modify the trusts in any way whatsoever; the only benefit appellants could receive from the trusts during the taxable years in question was in the event they, or any one of them, prevailed upon the particular co-trustees to exercise their discretion to distribute income. Again like *Cartinhour,* ". . . no part of the income was used for this purpose during the taxable years."

It is readily conceded that, had appellants, or any one of them, obtained whatever they desired of the trust income during the taxable periods in question, there would be evidence of an actual exercise of control sufficient to require attribution of all trust income for such periods to appellants, or any one of them, as the case might be. This, of course, would take us beyond the *Cartinhour* case and into a factual situation similar to *Franklin Flato,* 14 T. C. 1241 (1950), aff'd 195 F. 2d 580 (5th Cir., 1952).

In the *Flato* case, a mother and father each created three trusts, one for the benefit of each of their three sons. The first son, Franklin, was the sole trustee of the two trusts for the second son, Frederick, who was the sole trustee of the two trusts for Franklin. Franklin and

Frederick were co-trustees of the two trusts for the third son, Robert. Distributions of trust income were to be made at the discretion of the trustees. On page 1245 of 14 T. C. (1950), the Tax Court stated:

> "Three bank accounts were maintained, one for each group of trusts. From the deposits in the bank accounts of the trusts, distributions were made to the petitioners as beneficiaries of the respective trusts as follows: In 1941, to Robert, \$2500.00 from each trust, or a total of \$5000.00; in 1942, to Frederick, \$2000.00 from each trust, or a total of \$4000.00; to Robert, \$2000.00 from each trust, or a total of \$4000.00; to Franklin, \$1100.00 from each trust, or \$2200.00, as a contribution to his church; in 1943. to Frederick, \$3500.00 from each trust, or a total of \$7000.00. The distributions made to Robert in 1941 and 1942 were made because of a request made by him in which he stated that he needed the money. The distributions to Frederick were made because of a request and his statement that he needed money to live on and in 1943 he wanted money to buy a farm. The contributions to the church made from Franklin's trusts were at his request."

On page 1248, the Tax Court concluded:

> "The evidence indicates that the beneficiaries requested and got such amounts of trust income as they desired. The fair inference is that they got what they wanted."

Accordingly, in the *Flato* case, all of the income of the trusts for the taxable periods in question was attributed to the beneficiaries.

There can be no doubt that if the appellants "got what they wanted" of the trust income during the taxable years in question, there would be evidence of an actual exercise

of power over the trust income indicative of control. However, there have been *no distributions* to any of the appellants during any of the taxable periods in question [R. 19, 35]; further, there is no evidence that any of the appellants could have "got what they wanted" of the trust income. In short, there is no substantial evidence whatever to support the District Court's Findings and Conclusions which attributed the entire undistributed income for the taxable years in question to the appellants as primary beneficiaries. Income taxation was never designed to exact tribute from a source that did not receive income and was incapable of commanding the receipt of income.

3.

The Reasoning Expressed by the District Court in Support of Its Findings and Conclusions That the Appellants, as Beneficiaries of the Respective Trusts, Had Unlimited Power and Control Over the Corpus of the Trusts—To-wit, the Reciprocal Nature of the Trusts, the Lack of Independent Trustees, the Close Familial, Business and Trust Relationship of the Trustees With Each Other and the Unlimited Powers of Invasion of the Corpus—Has No Foundation in Law or Fact.

(a) There Is No Power to Invade Corpus.

As has been stated heretofore, nowhere in any of the trust instruments in question is there a power to invade the trust corpus.

(b) The Trusts Are Not "Reciprocal Trusts."

Secondly, the relevancy of the fact that the provisions of the respective trust instruments are essentially identical is not clear. While its line of reasoning is not clear, apparently the District Court would transpose the various

trustees and primary beneficiary of the same trust pursuant to the so-called "reciprocal trust" doctrine. If such is the case, the District Court's reasoning does violence to the essence of the "reciprocal trust" doctrine cases.

The "reciprocal trust" doctrine is applied only where one who has furnished consideration for the creation of a trust by another is empowered, pursuant to the provisions of the trust instrument, to do certain acts which would require attribution of the income to him had *he* made the transfer in trust. *Commissioner of Internal Revenue v. Warner,* 127 F. 2d 913 (9th Cir., 1942); *Lehman v. Commissioner of Internal Revenue,* 109 F. 2d 99 (2d Cir., 1940), certiorari denied, 310 U. S. 637, 60 S. Ct. 1080 (1940); *Estate of Louise De Witt Ruxton,* 20 T. C. 487 (1953).

As applied, the "reciprocal trust" doctrine places one who has furnished consideration for a transfer in trust in the position of the grantor; any controls that such person may then have are considered "retained" and not "acquired," thus bringing into play the various incidence of income and estate taxation effective when controls are retained by a "grantor." *E. g.,* Sections 166, 167 and 811 of the Internal Revenue Code of 1939. (Appendix.)

In the cases with which we are concerned, all consideration was furnished by Minnie Kanter who had absolutely no reserved powers or control over trust corpus or income. The appellants furnished no *quid pro quo* for the transfers in trust and had no control over the selection of the fiduciaries. There is thus no reason in law or fact to transpose their positions.

(c) There Is No Evidence of the Exercise of Control on the Part of the Appellants, and No Inference Arises That, Because of the Relationship of the Trustees and Appellants, the Trustees Are Amenable to the Appellants.

The third principle reason expressed for the District Court's general Findings and Conclusions that the appellants controlled the trust income and corpus is the relationship existing between the trustees and appellants as beneficiaries. This reasoning requires as a corollary a premise that, even in the absence of evidence to support such conclusion, such relationship *ipso facto* indicates amenability and control.

While in some instances the family relationship of a trustee and beneficiary, even though present, has not even been alluded to in opinions concluding that there was no evidence of control on the part of a trust beneficiary (*e. g., Hallowell v. Commissioner of Internal Revenue,* 160 F. 2d 536 (3rd Cir., 1947), where the beneficiary was the wife and the trustee was the son of the grantor), in other instances the courts have squarely met similar contentions on the part of the Commissioner.

In *Estate of Frederick S. Fish,* 45 B. T. A. 120 (1941) (Acq.), decedent created a trust for the benefit of his wife for life, remainder to his children. Decedent had an *inter vivos* power to terminate the trust with the consent of his wife. The trust was not terminated prior to decedent's death. The Commissioner contended that the *power* to terminate required the inclusion in decedent's gross estate of the value of the trust corpus. On page 123, the court answered this contention as follows:

> "He (Commissioner) says first that under the concept of family solidarity and in view of the wife's other interests, it cannot be assumed that she would

> fail to comply with a request by decedent. Such a doctrine would proceed further than seems warranted by any principle so far established. Even under such decisions as *Helvering v. Clifford,* 309 U. S. 331, the concept of family unity is an economic consideration rather than one of conduct or behavior. The inclusion in the husband's income of that derived from a trust of which members of his family are the beneficiaries results more from the view that family finances are a single unit generally furnished by the husband or father than that the action of individual members of the family group will necessarily accord with the dictates of its head." (Reference added.)

Note also *Commissioner of Internal Revenue v. Goodan,* 195 F. 2d 498 (9th Cir., 1952).

A similar situation existed in the case of *Lillian M. Newman,* 1 T. C. 921 (1943). In this case, petitioner set up two trusts for the primary benefit of her two minor children, with her husband as a remainderman. Petitioner's husband was also the trustee. As trustee, petitioner's husband had the power to revoke the trust in whole or in part whereupon all the trust property would be turned over to petitioner. The Commissioner sought to tax petitioner under numerous theories. In discussing the taxability of petitioner under Section 166 of the Internal Revenue Code of 1939, the court said, at page 924:

> "Our view was, and is, that the *Clifford* case does not mean that a person with an otherwise adverse interest will, solely by reason of marital relationship, act in accordance with the wishes of his or her spouse."

It is noted in the *Fish* and *Newman* cases that the conclusions that the trustee was not considered amenable to the beneficiary despite the close family relationship in-

volved was apparently influenced by the fact that the trustee was considered to have an interest adverse to that of the beneficiary. In this connection it should be further noted that the trustees in the instant cases are also "secondary beneficiaries" of the trusts of which they are fiduciaries, possessing interests contingent on the death of the primary beneficiary before January 2, 1960, without lawful issue or a lawful spouse surviving. [R. 32, 51.]

That the "secondary" interests of the trustees in the instant matters are "substantially adverse" to that of the primary beneficiaries, is illustrated by the case of *Meyer Katz,* 46 B. T. A. 187 (1942). In the *Katz* case petitioner created trusts primarily for the benefit of each of his three children with his wife as a contingent beneficiary. During the taxable year in question the trust could be terminated and part of the property revert to petitioner by delivery to the trustee of a written instrument directing such termination, executed jointly by petitioner and his wife. In holding that petitioner did not retain control over the corpus and was therefore not taxable under either the *Clifford* decision or Section 166 of the Internal Revenue Code of 1939, the court said, at page 194:

> "The petitioner's wife Helen was a living, definitely ascertained person who had the fixed right, in the event a primary beneficiary predeceased her without leaving issue, to have a substantial share of the trust income that might be currently distributed and of the entire trust estate, including accumulated income, distributed to her. Also, in our opinion, such contingent interest of the wife was a 'substantial adverse interest' to the grantor, petitioner, within the meaning of Section 166, *supra.*" (Citations omitted.)

The relevancy and interplay of Sections 166 and 167 (Appendix) with the doctrines of the *Clifford* and *Mal-*

linckrodt cases is indicated in the *Lillian M. Newman* case at page 925 of 1 T. C. where the Tax Court stated:

> "The *Clifford* case is cited only in connection with Section 166, as indicated above. Nevertheless, we deem it appropriate to express our conclusion that the petitioner is not taxable upon the trust income by virtue of Section 22(a). We have here long-term trusts with no control whatever reserved to the grantor. She did not remain the substantial owner of the trust fund. The fact that her husband was named trustee does not by itself require that the grantor be taxed. 'It is natural that the grantor of the trust will appoint as fiduciaries persons upon whose ability and integrity he may rely.' (Citation omitted.) In this case there is not only *a lack of evidence that petitioner could exercise control by dominating her husband,* but there *is* in fact testimony to the contrary. We hold that petitioner is not taxable under Section 22(a)." (Italics added.)

The *Fish, Newman* and *Katz* cases are thus authority for the premise that, even if the appellants in the instant proceedings were given *express* power in the trust instruments to convert either trust corpus or income thereof to themselves with the concurrence of the trustees, the broad implications of Section 22(a) would still not require attribution of the trust corpus or income to them. Lacking such express power, the instant cases present even weaker examples of control on the part of the appellants.

A more recent example of a situation factually stronger than the instant cases on the question of control on the part of a trust beneficiary is *Smither v. United States,* 108 Fed. Supp. 772 (S. D. Tex., 1952), affirmed in 205 F. 2d 518 (5th Cir., 1953). It could scarcely be denied that if, in the instant cases, the primary beneficiary of each trust

were also the sole trustee thereof, the contention of the Government and the conclusion of the District Court that the appellants had unlimited control over the trust property would be strengthened. The Government would then be in a position to argue that, as sole trustee, the beneficiary could distribute accumulated income to himself without limitation, under the fifth paragraph of the trust instrument, by virtue of the *Merchants National Bank of Boston v. Commissioner* decision, 320 U. S. 256, 64 S. Ct. 108 (1943); this case held that power to invade the corpus of a trust for "comfort, support, maintenance, and/or happiness of my wife" was not a standard capable of being stated in any definite terms of money. This holding related to a determination that income of a trust was taxable to the beneficiary to the extent to which income could have been diverted because of the uncertainty of this standard.

This very proposition was before the court in the *Smither* case. In the *Smither* case, for the years in question, 1944 and 1945, taxpayer was at once the trustee and primary beneficiary of a trust. The "fiduciary" of this trust was empowered to expend such part of the income and to invade the corpus of said estate for the support, maintenance, comfort and pleasure of Mrs. Smither (taxpayer) and of the children as in the discretion of the fiduciary "may appear to be proper or desirable." *No income was withdrawn by the trustee during any of the years in question.* The Commissioner had maintained that

> ". . . Mrs. Smither, as sole trustee during the years in question, had unlimited discretion to expend all or any part of the income for her own purposes, and hence the income should be taxable to her under *Corliss v. Bowers* . . . *Mallinckrodt v. Newman* . . . *Grant v. Commissioner* . . . and similar cases."

In holding that the income of the trust for the taxable years in question was not taxable to the taxpayer under Section 22(a) of the Internal Revenue Code of 1939, the Court stated, on page 774,

> "As sole surviving trustee, her use of the trust income remained subject not only to a compelling moral obligation to carry out the expressed desires of her deceased husband, but to a legal obligation as well, namely, that no more be withdrawn for her own purposes than was necessary for her support, maintenance, comfort and enjoyment, with a similar right in her children. In my opinion, this standard as set out in the will was sufficiently clear and definite to be both understandable and enforceable. When read in connection with other provisions of the will, and viewed in the light of the testator's circumstances, it means no more than that the needs of maintaining the family in the station of life to which it had become accustomed should be met . . .
>
> "The defendant urges *Merchants National Bank v. Commissioner,* 321 U. S. 256 . . . upon me as compelling a contrary result. It is true that the purposes for which the trust income might be utilized, or the corpus invaded, under terms of the trust there in question ('for the "comfort, support maintenance and/or happiness of my (said) wife"') are very similar to those before me. But the question presented to the court there was entirely different . . . I do not consider such authority in point on the question before me."

Certainly the *Smither* case presented a stronger position for the Commissioner than did the facts of the cases with which we are presently concerned.

In the instant cases there is no evidence to indicate that the trustees are amenable to the beneficiaries; there is no inference of control because of the family relationship. In fact, the contingent interests of the trustees in the trust estates provide an inference to the contrary. Further, by virtue of the *Fish, Newman, Katz* and *Smither* cases it is doubtful that the income of the trust estates for the years in question could be attributed to the primary beneficiaries even if they had certain limited *express* power over the trust property.

In final analysis, the importance of the trustee-beneficiary relationship in the instant matters is questionable in light of the explicit language of Treasury Regulation 111, Section 22(a)-22 (Appendix). This regulation, controlling for the last two taxable years involved in these proceedings, provides in part that,

> "Where a person other than the grantor of property transferred in trust has a power exercisable *soley by himself* to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person." (Italics added.)

Regulation 111, Section 22(a)-22 was enacted into statutory law as Section 678 of the Internal Revenue Code of 1954. In connection with Section 678, (Appendix) the editors of the American Law Institute, February, 1954, Draft of the 1954 Internal Revenue Statute state,

> "Thus a person is taxable under sub-sections (a) (1) and (2) only if a power is exercisable solely by himself. If a power is exercisable by a party who is related or subordinate to such person, the section will not apply."

The editors explained this administrative attitude as follows:

> "The basis of the requirement may be that a related or subordinate party is not always as fully controlled by such person as he would be by a grantor to whom he was similarly related or subordinate."

The appellants were given no express control over trust income or trust corpus; the appellants have not exercised any control over trust income or corpus. If the explicit language of Treasury Regulation 111, Section 22(a)-22, has any meaning whatever it would be immaterial even if appellants *were* given a measure of express power to be exercised with the concurrence of the Co-Trustees. As stated heretofore in connection with the significance of the *Fish, Newman,* and *Katz* cases, lacking such power, the instant cases present even weaker examples of control on the part of the appellants.

4.

Since Substantial and Irrevocable Gifts Were Effected Through the Trust Medium; the Absence of a Business Purpose and the Presence of Tax Savings Motives Does Not Render Invalid the Trusts Created Thereby.

The Disrict Court has concluded that the trusts in question were invalid because of the absence of a business purpose and the presence of tax reduction motives in setting up the trusts.

It cannot be denied that where the issue before the court is a recognition of a corporate reorganization, *Gregory v. Helvering,* 293 U. S. 465, 55 S. Ct. 266 (1935), or of a one-man corporation as a separate entity, *Higgins v. Smith,* 308 U. S. 473, 60 S. Ct. 355 (1940), or of a sale

and leaseback arrangement, *Shaffer Terminals, Inc.,* 16 T. C. 356 (1951), affirmed 194 F. 2d 539 (9th Cir., 1952), the existence of an independent business purpose for certain transactions may be very important. However, existence of a business purpose in creating a trust is not only not required by the revenue statutes or any cases but, in fact, should be singularly avoided lest the trust be held taxable as a corporation. In *Main-Hammond Land Trust v. Commissioner of Internal Revenue,* 200 F. 2d 308 (6th Cir., 1952), the Court states on page 311,

> "The essential distinctions between the ordinary trust and a trust which is an association and thus, under Section 3797, I. R. C., taxable as a corporation, have been described by the Supreme Court in *Morrissey v. Commissioner,* 296 U. S. 344 . . ."

In determining if a trust should be taxable as a true trust or held to be taxable as a corporation, the Court continued,

> "The crucial question is whether the trust was organized for a business purpose. In solving this question the underlying purpose for the creation of the trust must be considered."

In connection with the necessity of a business purpose consideration should be accorded the case of *W. P. Hobby,* 2 T. C. 980 (1943). In this case, in four instances preferred shares owned by the taxpayer were soon to be redeemed at par by the corporation, as the taxpayer expected, and he sold them in one instance to a friend for a price less than par so that the gain would be realized as a gain from a sale taxable as a long-term capital gain, and in three instances for par, after which the purchaser would receive a dividend. When the shares were redeemed, the taxpayer had sold them and was not the owner, and the purchasers received the redemption price from the cor-

poration. In holding that the gain of the taxpayer was taxable as a long-term capital gain from sale taxable under then Section 117 and not a short-term gain from liquidation and redemption, taxable under then Section 115, the Court said, on page 985,

> "The Commissioner argues that petitioner did not in fact sell, or may not be regarded as having sold, the shares. He says that this is because the alleged sale 'had no business purpose'. What kind of 'business purpose' must be shown as necessary to the recognition of a sale is not made clear, and there is no statutory requirement to that effect. . . . Petitioner, a shareholder, had an unrealized increment in his shares which he wanted to realize. Collaterally he wanted to use a legitimate transaction which would impose upon him the least tax. This is not an interdicted purpose. The primary purpose to realize the gain was a legitimate business purpose even though it also had a collateral favorable tax effect . . . The petitioner's tax saving purpose did not invalidate the sale."

The above quoted language was cited by the court in *Sun Properties v. United States,* 220 F. 2d 171 (5th Cir., 1955), where the court also strongly demonstrated the immateriality of tax savings motives when it paraphrased the United States Supreme Court on page 174, stating,

> ". . . the Supreme Court said that a motive of tax avoidance will not establish liability if the transaction does not do so without it. It may fairly be said that a tax avoidance motive must not be considered as evidence that a transaction is something different from what it purports to be . . .

"Legal transactions cannot be upset merely because parties have entered into them for purpose of minimizing or avoiding taxes which might otherwise accrue. (Citations omitted.)

"Nor does the fact that this transaction may not have had any business purpose other than saving taxes, rationally imply that it was not a sale."

Factually more in point is the case of *J. M. Walsh,* 18 B. T. A. 571 (1929). In this case taxpayers each owned own-half of the shares of the total outstanding stock of a corporation. The stock had a low basis in the hands of taxpayers. Taxpayers had received several good offers for the stock which they declined because of the large taxes; taxpayers then made a gift of three-fourths of their respective stock interests, in trust, to themselves as trustees, for the benefit of their respective families. The stock interests were sold and taxpayers reported profits on 12½ shares of stock (¼ of their prior holdings). The Commissioner sought to tax taxpayers on all of the profits (100% of their prior holdings). On page 576 the Court, in holding that taxpayers were taxable only on 12½ shares, stated,

"Relying upon the advice of an attorney, and for the admitted purpose of avoiding the payment of a large tax and with the intent to make absolute and irrevocable gifts, petitioners executed . . . the trust instruments set forth in the findings of fact . . . The courts have also held that a device to avoid or minimize the burden of the revenue acts may be resorted to if effectuated by legal means. (Citations omitted)."

In the cases with which we are presently concerned the existence of tax-savings motives on the part of Minnie

Kanter in employing trusts in effectively and irrevocably making gifts does not render the trusts invalid; the existence of a "business purpose" in creating the trusts would have been fatal to this admitted and valid purpose in employing the trusts in the first place and might bring the trusts under the doctrine of business trusts taxable as corporations. Further, it should be emphasized that, while Minnie Kanter's sole purpose in *employing* trusts was to reduce the income taxes that her children would have to pay, her choice of the *means* of conveyance was only incidental to her primary desire—to make gifts to her children and the potential issue of her children.

Unlike *Helvering v. Clifford* wherein, as concerned the relinquishment of dominion and control, "the trust did not effect any substantial change," 309 U. S. 331 at 335, Minnie Kanter irrevocably transferred all dominion, control, and economic benefit of the trust corpus and income. Gift taxes were paid on the transfers and a later deficiency based on the ground that "future interests" only were transferred to the beneficiaries was assessed and paid. As stated in the case of *Lura H. Morgan,* 2 T. C. 510 at page 515 (1943),

> "So long as the gift is valid and real a motive to reduce taxes becomes immaterial."

5.
Conclusion.

Since the Revenue Act of 1916, the history of trust taxation reveals a pattern of active administrative and congressional modification and refinement of principles designed to provide adequate guide posts for courts, taxpayers, and government agents to follow. Following the *Clifford* decision and the chaos and uncertainty left in its

wake, the Treasury Department published its regulations providing the "more precise standards or guides" suggested by the *Clifford* decision. These regulations were adopted almost verbatim in the Internal Revenue Code of 1954 in Sections 671 to 678, thus indicating congressional approval of the *status quo.*

The provisions of these statutes are very explicit and, according to Section 671 are intended to be exclusive. Section 671 provides in part as follows:

> "No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under Section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart."

Thus, the door was completely closed to any attempt on the part of the government to tax trust income to a grantor or other person under the general section defining gross income—Section 61, the former Section 22(a). The accompanying Senate Committee Report makes it clear that this is, in fact, the intent of the new law. The Senate Finance Committee report, S. Rept. 1622, 83rd Congress, 2nd Session, at page 365, states:

> "The effect of this provision (Section 671) is to insure that taxability of *Clifford* type trusts shall be governed solely by this subpart."

Much of existing case law had been based upon the Treasury Regulations discussed heretofore which have been accorded legislative approval by enactment into statutory

law. These decisions have firmly established that, unless a person is given *express* power pursuant to the trust instrument to deal with trust corpus or income in a manner consistent with ownership, or there is *substantial evidence* demonstrating an *actual* dealing with trust corpus or income in such a manner, income shall not be attributed to such person. In its Findings and Conclusions the District Court ignores these standards and provides, in essence, that even lacking the existence of *express power* or evidence of *actual power* exercised to obtain income, a person should nonetheless pay income tax if there is a possibility that he might have obtained income.

In so concluding, the District Court pays no heed to the legislative intent expressed in Section 671 of the Internal Revenue Code of 1954 and the accompanying Committee Reports, obliterates what standards have heretofore been provided by case law and Treasury Regulations, and takes a long step toward restoring the chaos which existed in the era immediately following the *Clifford* decision. *No case heretofore has gone so far.*

In discussing the effect of Section 22(a) of the Internal Revenue Code of 1939, as applied to beneficiaries and third persons, in Mertens, *Law of Federal Income Taxation,* Volume 6, Section 3724, page 551 (1948 revised volume), it is stated,

> ". . . It is noteworthy that in most of the instances wherein a beneficiary or third person has been held taxable with trust income under Section 22(a), as in substance the owner thereof, the degree of such

person's control over the trust has been clear and extensive. If less than that, such a result cannot justifiably be reached."

For the reasons and upon the grounds hereinabove set forth, appellants respectfully urge the Court to reverse the judgments of the Court below and to order judgment for appellants.

Respectfully submitted,

Bryant R. Burton,

Adrian P. Marshall,

Attorneys for Appellants.

APPENDIX.

I. Internal Revenue Code of 1939.

Section 22(a):

"General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income."

Section 166:

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor."

Section 167:

"(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23(o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

(c) Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor."

II. Internal Revenue Code of 1954.

Section 671:

"Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart."

Section 678:

"(a) General Rule.—A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

> (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or
>
> (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

(b) Exception Where Grantor Is Taxable.—Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is otherwise treated as the owner under sections 671 to 677, inclusive.

(c) Obligations of Support.—Subsection (a) shall not apply to a power which enables such person, in the capacity of trustee or co-trustee, merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income of the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661 (a) and shall be taxed to the holder of the power under section 662.

(d) Effect of Renunciation or Disclaimer.—Subsection (a) shall not apply with respect to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence."

III. Treasury Regulations.

"Reg. 111, Sec. 29.22(a)-22. Trust Income Taxable to Person Other Than Grantor.—Where a person other than the grantor of property transferred in trust has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person. Even though such a power has been partially released or otherwise modified so that the person holding it can no longer vest the corpus or the income of the trust in himself, the income shall continue to be taxable to such person if, after such release or modification, he has retained such control of the trust as would, within the principles of section 29.22(a)-21, subject a grantor of such a trust to tax on the income thereof. This section shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor is otherwise taxable under section 29.22(a)-21. See also Section 29.166-2.

"Section 22(a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to this section."